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NO. 89-1854 (3)

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

AMERICAN NATIONAL CAN CORPORATION, *et al.*,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent,

ON PETITION FOR A WRIT OF CERTIORARI TO THE WASHINGTON SUPREME COURT

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Should interstate businesses be relieved of the obligation to pay Washington B&O tax because other states have chosen to impose income, value added and property taxes that do not qualify for Washington's B&O tax credit rather than imposing manufacturing and selling transaction taxes that do qualify for Washington's B&O tax credit?

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WHAT THIS CASE IS REALLY ABOUT

Washington imposes transaction taxes on the activities of manufacturing and selling products in this State. As part of its tax system Washington adopted the credit mechanism suggested by this Court in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987). This credit mechanism entitles a business to take a credit against Washington's manufacturing and selling transaction taxes equal to the manufacturing or selling transaction tax it pays to another jurisdiction. Washington does not grant the credit for other types of

taxes paid by a business such as income, value added and property taxes.

Petitioners paid Washington tax on their manufacturing and selling activities in this State. Petitioners agree that there is sufficient nexus to impose the tax; that the tax is fairly apportioned; and that the tax is fairly related to the services provided by the State. Petitioners seek a refund of all the tax paid on their manufacturing and selling activities in Washington because they claim the tax discriminates against interstate commerce.

This case is not about the proper application of the credit. Petitioners did not claim credits under the law. Petitioners' complaint does not allege the State wrongly denied credit by improperly classifying a manufacturing or selling transaction tax that does qualify for credit as an income or other tax that does not qualify for credit.

Petitioners claim they should be relieved of all the tax on their manufacturing and selling activities because Washington does not allow credit for payment of different types of taxes, such as income, value added and property taxes, when other states choose to impose these taxes rather than imposing transaction taxes like Washington. The essence of petitioners' claim is that Washington cannot impose its manufacturing and selling taxes, unless the State grants interstate businesses a credit for any tax the businesses pay to another jurisdiction.

STATEMENT

The Statement of the Case presented by American National Can[1] (ANC) and other petitioners is largely irrelevant. The statement dwells on the history of Washington's business and occupation (B&O) tax and other tax alternatives to repair the system after *Tyler Pipe*, 483 U.S. 232 (1987). Pet. 2-6. Prior versions of the B&O tax and other tax alternatives are not before this Court. The one piece

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[1]For ease of reference we will simply refer to ANC when referring to petitioners unless the context indicates otherwise.

of history that is important - the rationale of this Court in *Tyler Pipe* - is barely discussed. ANC's discussion of the operation of the challenged tax credit is also incomplete and inaccurate. Pet. 6-9. Accordingly, we offer the following counterstatement.

I. OPERATION OF THE B&O TAX AND CREDIT.

A. Tyler Pipe Invalidated The Multiple Activities Exemption Because it Lacked Internal Consistency.

We begin with this Court's decision in Tyler Pipe and Washington's response to the decision. Tyler Pipe involved Washington transaction taxes imposed on the activities of manufacturing and selling.[2] The manufacturing tax was imposed on every person engaged in business as a manufacturer in Washington. Wash. Rev. Code § 82.04.240. Pet. 47a. The selling tax was imposed on every person making sales in Washington, either wholesale or retail. Wash. Rev. Code §§ 82.04.270, 82.04.250. Pet. 48a. The manufacturing and selling taxes had the same basic rate - .0044. Wash. Rev. Code §§ 82.04.240, 82.04.250, 82.04.270. These taxes also had the same measure - value of the products/ gross proceeds of sale.[3] The measure is the base to which the rate is applied.

These features of the B&O tax remain the same today and were of no concern to the majority in *Tyler Pipe*. The majority focused on the multiple activities exemption, Wash. Rev. Code § 82.04.440 (1985) which has since been

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[2]Some petitioners also challenge Washington's tax on extracting. Wash. Rev. Code § 82.04.230. Pet. 47a. Our discussion of manufacturing and selling also applies generally to extracting.

[3]The measure of the selling tax is the "gross proceeds of sales" in Washington. Wash. Rev. Code §§ 82.04.250, 82.04.270. The measure of the manufacturing tax is the "value of the products" manufactured, which is determined by the "gross proceeds derived from the sale thereof." Wash. Rev. Code §§ 82.04.240, 82.04.450.

repealed. The multiple activities exemption provided that "[p]ersons taxable under [retailing] or [wholesaling] shall not be taxable under [manufacturing] with respect to * * * manufacturing of the product so sold." Wash. Rev. Code § 82.04.440(2) (1985).

The majority held "Washington's multiple activities exemption invalid". 483 U.S. at 253. The former exemption from manufacturing tax was defective because it only applied if a business paid Washington selling tax. It did not apply if selling tax was paid to another state.

Thus, the multiple activities exemption violated the principle of internal consistency - "that is the [tax] must be such that, if applied by every jurisdiction, there would be no impermissible interference with free trade." 483 U.S. at 247 (quoting *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644 (1984)). If every jurisdiction imposed the transaction taxes at issue in *Tyler Pipe*, interstate commerce would pay two taxes - a manufacturing tax to Washington and a selling tax to another state - because the former exemption did not apply. Local commerce would pay only one tax - Washington selling tax - because the former exemption did apply.

An integral part of *Tyler Pipe* was the majority's explanation of how to repair the system. Washington could make the former exemption internally consistent by extending its benefits to interstate commerce. This Court stated:

> The * * * condition precedent for a valid multiple activities exemption eliminating exposure to the burden of a multiple tax on manufacturing and wholesaling would provide a credit against Washington tax liability for wholesale taxes paid by local manufacturers to any State, not just Washington.

483 U.S. at 246. This credit prescription was repeated later in the opinion when the Court stated that "an expansion of the multiple activities exemption to provide out-of-state manufacturers with a credit for manufacturing taxes

paid to other States would presumably cure the discrimination." 483 U.S. at 249.

Extending a credit to taxes on wholesale transactions and manufacturing transactions paid to any state, not just Washington, repairs the system by making it internally consistent.

B. After Tyler Pipe, Washington Adopted a Credit For Transaction Taxes Paid to Other Jurisdictions.

Tyler Pipe was handed down on June 23, 1987. Less than two months later on August 10, the Washington Legislature met in special session. The Legislature repealed the multiple activities exemption and enacted the credit mechanism suggested by this Court. Wash. Rev. Code § 82.04.440 (1987). Pet. 48a-50a.

Under the new credit mechanism both local and interstate businesses are entitled to a tax credit against Washington's selling tax. The Washington transaction tax imposed on the sale of a product may be reduced by the amount of manufacturing tax paid to Washington or another jurisdiction on the transaction of manufacturing the product. Wash. Rev. Code § 82.04.440(2).

A credit is also available for Washington manufacturers selling in interstate commerce.[4] This is a credit against Washington manufacturing tax. The Washington tax imposed on the transaction of manufacturing a product may be reduced by the amount of selling tax paid to another jurisdiction on the transaction of selling the product. This credit is only available for selling tax paid to a jurisdiction other than Washington. Wash. Rev. Code § 82.04.440(3). The end result is the two-way credit mechanism prescribed in *Tyler Pipe*.

ANC's description of the operation of the credit is incomplete. ANC gives the impression that only taxes in

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[4]This credit was initially adopted on a contingent basis in 1985 and went into effect when *Tyler Pipe* was decided. Wash. Laws 1985, c. 190 § 1.

Delaware, Hawaii and Indiana qualify for credit. ANC neglects to mention that Washington allows credit for taxes paid to the political subdivisions of other states as well as any foreign country or political subdivision thereof. Wash. Rev. Code § 82.04.440(5)(b) (ii), (iv).[5]

The credit is working. Between June 1987 and October 1988 interstate businesses claimed credits totaling $1,303,973. Pet. 34a. ANC complains that this sum is insignificant. Pet. 9. However, ANC is well aware that some businesses have elected not to claim the credit.

Twelve of the petitioners in this case have paid taxes that qualify for credit but they have not claimed the credit.[6] According to the twelve petitioners' calculations, the total amount of unclaimed credit is $69,981 for the period between September 1987 and August 1988.[7] Two other petitioners paid qualifying taxes but they did not calculate the amount of the credit or claim it.[8] (Another eight petitioners did not claim credit because they report paying no taxes to any jurisdiction save Washington, even though they are engaged in interstate commerce.[9])

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[5]In this respect Washington enacted a more extensive credit than *Tyler Pipe* required. Local business in Washington receives no credit against State B&O taxes for B&O taxes paid to Washington political subdivisions. Yet Washington allows a credit against its B&O taxes for taxes paid to the political subdivisions of other states. Wash. Rev. Code § 82.04.440(5)(b)(i), (ii). ANC's appendix lists taxes from 27 jurisdictions that qualify for credit. Pet. 26a-36a. However, ANC omits the fact that this number has increased. At present there are 58 jurisdictions that impose qualifying taxes including a tax imposed by Canada. Excise Tax Bulletin 543.04.19301 (June 30, 1989). This list is not exclusive. The process of idenifying qualifying taxes is ongoing.

[6]According to these twelve petitioners, they did not claim the credit because they thought a special and expensive record keeping system was necessary. See *infra* p. 6, n.7. Petitioners apparently misunderstood the law. The State does not require a special record keeping system and verifies the credit the same way it verifies other tax adjustments. Affidavit of Les Jaster.

[7]Petitioners obtained a protective order requiring the State to refer to affidavits by number rather than by name. Petitioners' Affidavit Nos. 79, 81, 82, 84, 86, 88, 91, 92, 94, 95, 99, 100.

[8]Petitioners' Affidavit Nos. 1, 48.

[9]Petitoners' Affidavit Nos. 30, 36, 38, 43, 45, 47, 51, 55.

At this point it is impossible to know the cost of the credit to Washington.[10] The statute of limitations for 1987, the first year of the credit's operation, does not expire until December 31, 1991. Wash. Rev. Code §§ 82.32.060, 82.32.050. Businesses will be entitled to seek refunds, owing to credits claimed, until that date.

ANC asserts that Washington only allows credit if the labels and calculations of another jurisdiction's taxes conforms perfectly with Washington's taxes. Pet. i, 8-9, 18-19. In the proceedings below ANC did not challenge the Washington Department of Revenue's (Department) decision to disallow credit for any particular tax. ANC's complaint challenges the imposition of Washington's manufacturing and selling taxes without regard to the credits available under the law.[11]

Moreover, ANC's claim that Washington requires perfect conformity is inaccurate. It is true that Washington does not allow credit for some different kinds of taxes such as income, value added and property taxes. But these taxes are fundamentally different from transaction taxes like Washington's B&O tax on manufacturing and selling.[12]

We can demonstrate that ANC's claim is inaccurate by looking at the taxes already qualified for credit. Washington has approved taxes for credit with different labels than Washington. For example: Indiana's "Gross Income" tax and Kansas City, Missouri's "License Fee" have different labels but qualify for credit. Pet. 28a, 30a.

Washington also allows credit for taxes with different calculations. For example, Washington allows credit for

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[10]When the credit mechanism was pending before the Legislature the Department of Revenue estimated the cost of the credit, during the 1987-89 biennium, to be $42 million. Exhibit 7. The Department subsequently reduced this estimate to $30 million. Exhibit 12.

[11]Petitioners' Supplemental Complaint § 2.2 states: "Plaintiffs are entitled to refunds of all B&O taxes paid and which will be required to be paid in the future on the grounds that the Replacement B&O Tax law violates the United States Constitution and is, therefore, invalid."

[12]See *infra* p. 12-13.

the payment of Delaware's Manufacturer's License Fee, Del. Code Ann. tit. 30 § 2702(b) (1988). Pet. 28a. In computing the tax Delaware does not tax the first $600,000 of aggregate gross receipts each month. Del. Code Ann. tit. 30 § 2702(b)(1) (1988). On the other hand, Washington's B&O tax applies to all gross receipts in excess of $1,000 per month. Wash. Rev. Code § 82.04.300. This difference did not disqualify the Delaware tax.

II. APPLICATION OF THE B&O TAX CHALLENGED BY ANC.

To put the case in context we will briefly describe how the B&O tax applies to petitioners. Since ANC challenges both the manufacturing and selling taxes, it represents the basic fact pattern for all petitioners.

ANC sells packaging products throughout the world. These products are manufactured by ANC in 28 states, including Washington. Pet. 38a, §§ 1.1.2, 1.1.3. ANC employs approximately 240 people in Washington. These employees are involved in the manufacture of products at two plants located in this State. This number also includes ANC's Washington sales office. Pet. 38a §§ 1.1.4, 1.1.6.

ANC pays manufacturing B&O tax on the transactions of manufacturing products in Washington that it sells elsewhere. If the value of the products ANC manufactures in Washington is $1,000, its manufacturing tax is $4.40 ($1,000 x .0044). ANC also pays selling B&O tax on the transactions of selling products in Washington that it manufactures elsewhere. If the gross proceeds of ANC's Washington sales is $1,000, its selling tax is $4.40.

Because the B&O tax is a transaction tax, it does not apply to transactions that take place outside this State. Thus, if ANC manufactures $1,000 of goods in California and sells them in Oregon, there is no Washington tax on that $1,000.

ANC seeks a refund of all of the manufacturing and selling taxes it has paid. ANC claims there should be no

B&O tax on its manufacturing and selling activities in Washington. For the period between September 1987 and August 1988, 30 petitioners in this case seek a refund of manufacturing tax in the amount of $10,535,715[13] and 60 petitioners seek a refund of selling tax in the amount of $11,176,970.[14]

REASONS WHY THE PETITION SHOULD BE DENIED

I. ANC MISCHARACTERIZES THE ISSUE IN THIS CASE.

ANC mischaracterizes the issue in this case. According to ANC the issue is whether Washington can limit application of the credit by requiring the labels and calculations of other states' taxes to conform precisely to Washington's. Pet. i. ANC tries to create the impression that the State has denied credit for manufacturing and selling transaction taxes by improperly classifying them as income or other taxes. This characterization is inaccurate. See *supra* p. 7-8.

More important for purposes of this Court's jurisdiction, the issue before the Court does not involve the question whether the State denied credit by improperly classifying a manufacturing or selling transaction tax as an income or other tax. The Washington Supreme Court recognized this in the decision below:

> The taxpayers do not challenge the interpretation of the statute or the Department's selection of taxes. * * * Nor do they argue that the Legislature or the Department failed to provide credits for every manufacturing tax. The taxpayers in effect concede that the Legislature did what the Supreme Court said

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[13]Petitioners' Affidavit Nos. 6, 17, 18, 20, 21, 30, 35, 36, 38, 40, 42, 45, 46, 47, 49, 50, 51, 52, 54, 55, 56, 57, 62, 65, 69, 70, 71, 74, 76, 77.

[14]Petitioners' Affidavit Nos. 1, 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 22, 23, 24, 25, 26, 27, 28, 29, 31, 32, 33, 34, 37, 39, 41, 43, 44, 46, 48, 49, 50, 52, 53, 56, 57, 58, 59, 60, 61, 63, 64, 65, 66, 67, 68, 69, 70, 72, 73, 74, 75, 76.

was necessary in *Tyler*.

> But they object to the fact that by its terms the new law grants no credits for income taxes or excise taxes paid in other states.

American National Can Corp. v. Dept. of Revenue, 114 Wash.2d 236, 242, 787 P.2d 545 (1990). Pet. 5a.

The record in this case supports the Washington Supreme Court's statement. ANC discusses taxes in Oregon,[15] Michigan,[16] and Alaska[17], it claims were improperly excluded. Pet. 12-15. However, only one of these taxes was included in ANC's January 14, 1988 request to the Department for a ruling on whether certain taxes qualified for credit.[18] The Department denied credit for that tax. Pet. 31a. However, ANC's complaint does not take issue with the Department's ruling.

A taxpayer is certainly entitled to challenge the Department's decision to disallow credit for a particular tax. Whether such a challenge will produce a substantial federal question to be resolved by this Court remains to be seen. However, it is not this case. What is before this Court is ANC's assertion that if Washington allows a credit for one kind of tax, it must allow a credit for every tax paid by an interstate business.

II. THE COMMERCE CLAUSE DOES NOT REQUIRE WASHINGTON TO ALLOW CREDIT FOR THE PAYMENT OF INCOME AND OTHER TAXES.

A. The Internal Consistency Test Does Not Require a State to Give Credit for Other Types of Taxes.

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[15]Or. Rev. Stat. § 317.070 (1989). Pet. 53a.

[16]Mich. Comp. Laws § 208.31 (1989). Pet. 53a.

[17]Alaska Stat. §§ 43.55.011, 43.75.015 (1989). Pet. 50a-51a.

[18]Alaska Stat. § 43.75.015. Pet. 28a-29a, 31a-32a.

The gravamen of ANC's attack on the B&O tax is that Washington only allows credit for manufacturing and selling transaction taxes and that too few taxes qualify because other states impose different types of taxes such as income taxes. Pet. 12-14. Essentially ANC claims that if a state treats two taxes as equivalent for local purposes through a credit mechanism - like the manufacturing and selling taxes - it must treat every tax as equivalent. And the state must allow interstate businesses a credit for any tax they pay to another state.

The internal consistency test applied by this Court in *Tyler Pipe*, 483 U.S. 232 (1987) does not require credit for different kinds of taxes that are not treated as equivalent by the state itself. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Goldberg v. Sweet*, 109 S.Ct. 582, 589 (1989). Under the internal consistency test, if a state treats two taxes as equivalent for local purposes it must treat those taxes as equivalent when paid to another state.

This Court's decisions involving credits recognize this principle. For example, the use tax sustained in *D. H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) included a credit. The credit was limited to "taxpayers who have paid a *similar tax* upon the sale or use of the same tangible personal property in another state." 486 U.S. at 31 (quoting La. Rev. Stat. Ann. § 47:303(A) (West 1970)) (Emphasis added). In *Goldberg* the Court approved an Illinois telecommunications tax with a credit for "other States' telecommunication taxes". 109 S.Ct. at 590. Even in *Tyler Pipe* this Court referred to a credit for "wholesale taxes paid by local manufacturers to any State, not just Washington" and a credit for "manufacturing taxes paid to other States". 483 U.S. at 246, 249.

The taxes in *Holmes* and *Goldberg* are valid even though the credits only applied to similar taxes. The same is true of Washington's manufacturing and selling taxes.

The validity of these taxes does not turn on allowing credit for different types of taxes such as income taxes.

In *Goldberg*, 109 S.Ct. at 589, this Court recognized that Washington's manufacturing and selling taxes are similar to the sales and use taxes in *Holmes* and the telecommunications tax in *Goldberg*. The key is that all of these taxes are on specific transactions - the activity of selling a product; the activity of using a product; the activity of manufacturing a product; or the activity of making a telephone call - measured by the gross receipts from that specific transaction.

An income tax is fundamentally different because it is not concerned with any particular transaction.[19] Instead, the income tax focuses on a business' total income from all activities.[20] This Court recognized the fundamental difference between an income tax and a transaction tax in *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980). In *Exxon* the taxpayer sought to exclude from the measure of its Wisconsin income tax the income on oil and gas extracted in other states. The taxpayer argued that other states' severance taxes posed a risk of multiple burden. A severance tax is another kind of transaction tax.

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[19]Similarly, value added taxes are fundamentally different than transaction taxes. "Both income taxes and value-added taxes are taxes on the economic process .* * * In the end, the income tax and the [value-added tax] tax the same things, but at different stages of the economic process, and thus generate the same amount of revenue and affect the economy identically." *Mobil Oil Corp. v. Department of Treasury*, 422 Mich. 473, 373 N.W.2d 730, 739-40 (1985).

[20]The fundamental difference between transactions taxes like Washington's selling and manufacturing taxes and income taxes also means it would be extremely difficult to provide a credit for an income tax. When a retail sales tax or manufacturing tax is paid with regard to a particular product it is relatively easy to apply the credit to offset a use tax or selling tax on that product. An income tax is paid on apportioned net income. There is no way to know what part of the tax relates to a particular manufacturing or selling activity. In addition, "all sales are not equally profitable". *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 276 (1978). Thus, if a business pays income tax in a state where it has a manufacturing facility, it would be exceedingly difficult to know what part of the tax was attributable to Washington sales and what part of the tax was attributable to sales in another state–not to mention the fact that some of the tax may be attributable to income having nothing to do with the businesses' selling or manufacturing activities.

The transaction is the activity of taking or producing minerals and other natural resource products.

The Court rejected this argument noting the fundamental differences between these types of taxes. The Court stated:

> Severance taxes, however, are directed at the gross value of the mineral extracted or the quantity of production rather than the net income derived from the production activities. * * * The Wisconsin Supreme Court therefore properly concluded that "[t]he fact that the producing states may impose * * * severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income."

447 U.S. at 228-9 n.12 (citations omitted). Transaction taxes are directed at a different aspect of a business than income taxes.

B. ANC's Claim is Contrary to The Principle That The Validity of a State's Tax Does Not Depend on Other States' Taxes.

ANC agrees that Washington's tax system is internally consistent (Pet. 9) but still maintains that the taxes are discriminatory. ANC's complaint is that too few taxes qualify for credit. Would this complaint disappear if more states enacted manufacturing and selling taxes similar to Delaware, Hawaii and Indiana[21] or would it require such action by all other states?

The sole reason Washington's credit does not apply more broadly now is that other sovereign states have made different tax choices - enacting income and other taxes instead of transaction taxes on manufacturing and selling. ANC's whole claim is based on the fact that other states have made these choices.

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[21]Pet. 28a.

ANC's contention is directly contrary to the principle that the validity of one state's tax system does not depend on the tax laws of other states. *Freeman v. Hewitt*, 329 U.S. 249, 256 (1946). Instead of looking to other states' tax laws, as ANC suggests, this Court developed the internal consistency test.

The Court applies the hypothetical internal consistency test because "[a]ny other rule would mean that the constitutionality of [a State's] tax laws would depend on the shifting complexities of the tax codes of 49 other States * * *. *Tyler Pipe*, 483 U.S. at 247 (quoting *Armco*, 467 U.S. at 644-45).

This Court has already rejected the contention that an internally consistent tax can be invalidated because of different taxes imposed by other states. The Court rejected essentially the same claim in *Goldberg* where the taxpayer sought to broaden the internal consistency test to include other types of taxes. The Court refused stating:

> If we were to determine the internal consistency of one State's tax by comparing it with slightly different taxes imposed by other States, the validity of state taxes would turn solely on "the shifting complexities of the tax codes of 49 other States."

109 S. Ct. at 589.

The fact that two states have different tax systems does not render either of them discriminatory. The Court spoke to this point in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978). In *Moorman* the taxpayer made a similar claim that the interaction of Iowa's single factor apportionment formula and Illinois' three factor formula rendered Iowa's tax system discriminatory. The Court rejected the discrimination claim:

> The simple answer, however, is that whatever disparity may have existed is not attributable to the Iowa statute. It treats both local and foreign concerns with an even hand; the alleged disparity can only be the consequence of the combined effect of the Iowa *and* Illinois statutes, and Iowa is not responsible for the latter.

437 U.S. at 277 n.12.

Likewise, Washington treats interstate and local business with an even hand. The credit applies to manufacturing and selling taxes paid to any jurisdiction. Washington is not responsible for the fact that other states have adopted income and other taxes instead of manufacturing and selling taxes.

III. WASHINGTON'S B&O TAX AND CREDIT FOLLOW THIS COURT'S DECISION IN TYLER PIPE AND DO NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

ANC argues that both the manufacturing and selling B&O taxes violate the Commerce Clause, art. I, § 8, cl. 3 of the United States Constitution. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) this Court laid down four tests for assessing the Commerce Clause validity of a state tax: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state.

Before the Washington Supreme Court ANC agreed that there was (1) sufficient nexus to impose the tax; (2) that the tax was fairly apportioned; and (4) that the tax was fairly related to the services provided by the state. ANC's challenge was based solely on the third prong - that a tax must not discriminate against interstate commerce. *American National Can*, 114 Wash.2d 236, 241. Pet. 4a.

The discrimination prong prohibits a state from imposing a tax "which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business." *Boston Stock Exchange v. State Tax Comm'n.*, 429 U.S. 318, 329 (1977) (citations omitted). That is,

"a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Armco, Inc. v. Hardesty*, 467 U.S. 638, 642 (1984).

Washington's selling and manufacturing taxes do not discriminate against interstate commerce, for Washington does not tax the activities of manufacturing and selling more heavily when they cross state lines.

ANC describes Washington's credit as an "artifice" (Pet. 16) and urges the Court to take this case because other states will observe that Washington will have cured the discrimination condemned in *Tyler Pipe* without eliminating the reality of disparate treatment of local and interstate business. Pet. 16.

ANC's statement completely ignores the holding of *Tyler Pipe*, 483 U.S. 232 (1987). The disparity of treatment was that the former multiple activities exemption applied upon the payment of Washington selling tax, but did not apply upon the payment of selling taxes to other states. See *supra* p. 3-5.

When ANC speaks of disparate treatment, it always refers to a system that utilizes a three factor apportionment formula. Pet. 9, 16 n.13. Yet *Tyler Pipe* did not invalidate the multiple activities exemption on apportionment grounds and ANC now concedes that Washington's manufacturing and selling taxes are fairly apportioned.

The lesson others states may properly draw from *Tyler Pipe* is that the Court will apply the internal consistency test to determine whether a system of credits is valid. If a state treats two taxes as equivalent for local purposes through a credit mechanism - like sales and use taxes or manufacturing and selling taxes - it must treat those taxes as equivalent when paid to other states.

ANC separately challenges both the manufacturing tax and the selling tax. However, the petition tends to mush the two together. This makes the analysis needlessly complex. Accordingly, we will discuss the manufacturing

and selling taxes separately and demonstrate that there is no discrimination.

A. The Manufacturing Tax Does Not Discriminate, For All Manufacturers Are Subject to The Tax and Interstate Business Receives a Credit if it Pays Selling Tax Elsewhere.

The former multiple activities exemption at issue in Tyler Pipe excused manufacturing tax if selling tax was paid to Washington - but not if selling tax was paid to another state. As a result the manufacturing tax was imposed primarily on interstate rather than local business.

This problem was completely eliminated when the Washington Legislature repealed the multiple activities exemption. Now all Washington manufacturers are subject to manufacturing tax at the same rate and measure. If a Washington manufacturer produces goods worth $1,000 and sells them locally, its Washington manufacturing tax is $4.40 ($1,000 x .0044). A Washington manufacturer selling $1,000 of goods elsewhere is subject to exactly the same Washington manufacturing tax.

Washington does not tax the incident of manufacturing more heavily when it crosses state lines than when it occurs entirely within the State. ANC concedes that Washington's manufacturing tax is internally consistent. Pet. 9. If every state imposed Washington's manufacturing tax, there would be no impermissible interference with free trade. Thus, under the decisions of this Court including *Tyler Pipe* there is no discrimination.

ANC asserts that discrimination exists because local manufacturers, selling in Washington, may take a credit against Washington selling tax, but interstate manufacturers receive no such benefit. Pet. 14. This is not true. A Washington manufacturer selling elsewhere is entitled to a credit against its Washington manufacturing tax for selling tax paid to another jurisdiction. If a Washington man-

ufacturer is subject to selling tax of $4.40 on the sale of $1,000 of goods in Delaware, for example, it will pay absolutely no Washington tax on the transaction of manufacturing those goods. Again, local and interstate businesses are treated with an even hand.

B. The Selling Tax Does Not Discriminate, For Both Local and Interstate Businesses Can Take a Credit Against The Selling Tax.

ANC argues that the selling tax discriminates because a local business that pays Washington manufacturing tax receives a credit against Washington's selling tax. On the other hand, an interstate business manufacturing in a state without a manufacturing transaction tax is not entitled to a credit against Washington's selling tax. Pet. 13. ANC's argument is based solely on the fact that other sovereign states impose different kinds of taxes. ANC ignores the fact that an interstate business that pays manufacturing tax to another jurisdiction, such as Delaware, also receives a credit against Washington selling tax. The only difference turns on the tax decisions made by other states.

Furthermore, even when an interstate business pays Washington selling tax there is no discrimination, for a local business must pay manufacturing tax to obtain the credit. For example, a local business will pay manufacturing tax of $4.40 on the manufacture of goods worth $1,000 (.0044 x $1,000). An interstate business will pay $4.40 of selling tax - calculated on the same measure and rate - on the sale of $1,000 of goods in Washington. Thus, Washington does not tax an activity or incident more heavily when it crosses state lines.

The Court has already rejected ANC's reasoning in the context of retail sales and use taxes. A local business buying equipment in Washington is subject to retail sales tax. The business is automatically exempt from the Wash-

ington use tax imposed on the privilege of using property in this State. A business that purchases equipment in interstate commerce for use in Washington is subject to Washington use tax. There is no automatic exemption, but the business is entitled to a credit against the use tax if it pays retail sales or use tax to another jurisdiction. However, the credit is only allowed for the payment of retail sales or use tax. There is no credit for the payment of other types of taxes such as income or property taxes. Thus, to use ANC's example (Pet. 13), if a business buys equipment in Oregon (which has no sales and use tax), there is no credit and the business must pay a Washington use tax which local purchasers do not pay.

Although the interstate business pays a use tax not paid by local business this Court sustained Washington's use tax in *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) because local business pays retail sales tax. There is no discrimination.

> When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed.

Tyler Pipe, 483 U.S. at 246 n.14 (quoting *Silas Mason*, 300 U.S. at 584).

In *Tyler Pipe* Washington did not allow a credit for selling taxes paid to other states. As a result of this defect this Court did not find the use tax analogy persuasive. However, this Court clearly indicated that the analogy would be persuasive if Washington allowed credit for selling taxes paid to other states. The Court stated:

> [In *Silas Mason* we] upheld the [use] tax because, in the context of the overall tax structure, the burden it placed on goods purchased out-of-state was identical to that placed on an equivalent purchase within the State. This identical impact was no fortuity; it was guaranteed by the statutory exemption from use tax for goods on which a sales tax had already been paid,

> regardless of whether the sales tax had been paid to Washington or any other State.

483 U.S. at 245 (footnotes omitted). This Court immediately went on to indicate that a similar credit would cure the defect. The Court said:

> The parallel condition precedent for a valid multiple activities exemption eliminating exposure to the burden of a multiple tax on manufacturing and wholesaling would provide a credit against Washington tax liability for wholesale taxes paid by local manufacturers to any State, not just Washington. The multiple activities exemption only operates to impose a unified tax eliminating the risk of multiple taxation when the acts of manufacturing and wholesaling are both carried out within the State. The exemption excludes similarly situated manufacturers and wholesalers which conduct one of those activities within Washington and the other activity outside the State.

483 U.S. at 246-47.

By extending a credit to interstate business Washington also solved another problem the Court found analytically troubling in *Tyler Pipe*. The former multiple activities exemption treated the manufacturing and selling taxes as equivalent for local business but did not treat them as equivalent for interstate business. This caused the Court to conclude that manufacturing and selling were not "substantially equivalent events such that taxing the manufacture of goods sold outside the State can be said to compensate for the State's inability to impose a wholesale tax on those goods." 483 U.S. at 243 (footnote omitted).

Now, however, Washington treats its selling and manufacturing taxes as equivalent for both local and interstate business, for the credit applies to manufacturing and selling taxes paid to any jurisdiction, not just Washington. This corrected the defect identified by this Court in *Tyler Pipe*.

IV. WASHINGTON DOES NOT CONDITION THE AVAILABILITY OF THE CREDIT ON RECIPROCITY FROM SISTER STATES.

ANC alleges that the credit violates *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) because Washington requires other states to conform their tax labels and calculations to Washington's. Pet. 17. ANC's argument continues to misconstrue the issue in this case. The question of which taxes qualify for credit is not before the Court. Properly stated, the question is whether the exclusion of different types of taxes, such as income or property taxes, violates *New Energy*. The answer to this question is no - for two reasons.

First, ANC misreads *New Energy*. The case concerned an Ohio law "providing Ohio gasohol dealers a credit of so many cents per gallon of ethanol used in their product against the Ohio motor vehicle fuel sales tax payable on both ethanol and gasoline." 486 U.S. at 272. The controversy centered around a requirement of reciprocity from other states. Ohio denied "the credit to ethanol coming from States that do not grant a tax credit, exemption or refund to ethanol from Ohio * * *." *Id.* The Court ruled that the reciprocity requirement was discriminatory. 486 U.S. at 274-75.

Washington's credit mechanism does not require reciprocity. If a manufacturing or selling tax is paid to another jurisdiction, Washington allows credit - even if the other jurisdiction does not grant credit for the payment of Washington taxes.

New Energy does not prohibit a state from allowing a credit for some taxes and not for other taxes. Again, the sales and use tax analogy is useful. The use tax approved in *D. H. Holmes*, 486 U.S. 24 (1988) only allowed credit for payment of "a similar tax". 486 U.S. at 31. There was no credit allowed for the payment of other types of taxes such as income or property taxes. However, there was no reciprocity requirement in *D. H. Holmes* and thus no violation

of *New Energy*. Reciprocity is the evil at which *New Energy* is directed. Washington's credit mechanism does not have a reciprocity requirement.

The second reason *New Energy* does not apply is that Washington's tax system does not place interstate products at a commercial disadvantage. To understand the commercial disadvantage in *New Energy* assume:

1. The motor vehicle fuel sales tax was 10 cents a gallon
2. The credit for ethanol was 02 cents a gallon.

Under these assumptions 100 gallons of motor fuel, containing 50 gallons of Ohio ethanol, was subject to a total Ohio tax of $9.00.

$10.00 .....100 gallons motor fuel x 10 cents motor vehicle fuel sales tax
– 1.00 .....50 gallons of ethanol x 02 cents credit per gallon
$ 9.00 .....motor vehicle fuel sales tax on 100 gallons of motor fuel containing 50 gallons of Ohio ethanol

If a state did not reciprocate, the Ohio credit was unavailable. The Ohio motor vehicle fuel sales tax on 100 gallons of motor fuel, containing 50 gallons of ethanol from such a state, was $10.00 (1,000 gallons x 10 cents). A commercial disadvantage existed because the Ohio tax on interstate commerce of $10.00 was greater than the Ohio tax on local commerce of $9.00.

The problem in *New Energy* does not exist in Washington. A local business manufacturing and selling $1,000 of goods in this state pays $4.40 in manufacturing B&O tax ($1,000 x .0044). The tax on an interstate transaction (either manufacturing or selling) in Washington is also $4.40 on $1,000 of goods. In addition, if another state imposes a manufacturing or selling tax, the Washington tax will be reduced correspondingly by the credit. Thus, if an interstate business pays $4.40 of selling tax to Delaware

on the sale of $1,000 of goods made in this State, the Washington manufacturing tax is zero. Unlike *New Energy*, Washington imposes an equal burden on interstate and local commerce.

CONCLUSION

For the reasons given above, the Petition for a Writ of Certiorari should be denied.

DATED this 27th day of July, 1990.

Respectfully submitted,

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